



## SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-73613; File No. SR-NYSEArca-2014-127)

November 17, 2014

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Use of Derivative Instruments by the First Trust Preferred Securities and Income ETF

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (the “Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that, on November 5, 2014, NYSE Arca, Inc. (the “Exchange” or “NYSE Arca”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to reflect a change to the means of achieving the investment objective applicable to the First Trust Preferred Securities and Income ETF (the “Fund”) relating to its use of derivative instruments. The Fund is currently listed and traded on the Exchange under NYSE Arca Equities Rule 8.600 (“Managed Fund Shares”). The text of the proposed rule change is available on the Exchange’s website at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements

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<sup>1</sup> 15 U.S.C.78s(b)(1).

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.

concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Commission has approved listing and trading on the Exchange of shares (“Shares”) of the Fund under NYSE Arca Equities Rule 8.600, which governs the listing and trading of Managed Fund Shares on the Exchange.<sup>4</sup> The Shares are offered by the First Trust Exchange-Traded Fund III (the “Trust”), which was organized as a Massachusetts business trust and is registered with the Commission as an open-end management investment company.<sup>5</sup>

First Trust Advisors L.P. (“First Trust Advisors”) is the investment adviser (“Adviser”) to the Fund. Stonebridge Advisors LLC serves as sub-adviser (“Sub-Adviser”) to the Fund.

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<sup>4</sup> The Commission originally approved the listing and trading of the Shares on the Exchange on February 8, 2013. See Securities Exchange Act Release No. 68870 (February 8, 2013), 78 FR 11245 (February 15, 2013) (SR-NYSEArca-2012-139) (“Prior Order”). See also Securities Exchange Act Release No. 68458 (December 18, 2012), 77 FR 76148 (December 26, 2012) (SR-NYSEArca-2012-139) (“Prior Notice,” and together with the Prior Order, the “Prior Release”).

<sup>5</sup> The Trust is registered under the Investment Company Act of 1940 (“1940 Act”). On February 28, 2014, the Trust filed with the Commission an amendment to its registration statement on Form N-1A (File Nos. 333-176976 and 811-22245) under the Securities Act of 1933 (“Securities Act”) and under the 1940 Act relating to the Fund (“Registration Statement”). The descriptions of the Shares and the Fund contained herein are based, in part, on information in the Registration Statement. In addition, the Commission has issued an order granting certain exemptive relief to the Trust under the 1940 Act. See Investment Company Act Release No. 30029 (April 10, 2012) (File No. 812-13795) (the “Exemptive Order”).

In this proposed rule change, the Exchange proposes to change the description of the Fund's use of derivative instruments, as described below.<sup>6</sup>

On December 6, 2012, the staff of the Commission's Division of Investment Management ("Division") issued a no-action letter ("No-Action Letter") relating to the use of derivatives by actively-managed exchange-traded funds ("ETFs").<sup>7</sup> The No-Action Letter noted that, in March of 2010, the Commission announced in a press release that the staff was conducting a review to evaluate the use of derivatives by mutual funds, ETFs, and other investment companies and that, pending completion of this review, the staff would defer consideration of exemptive requests under the 1940 Act relating to, among others, actively-managed ETFs that would make significant investments in derivatives.

The No-Action Letter stated that the Division staff will no longer defer consideration of exemptive requests under the 1940 Act relating to actively-managed ETFs that make use of derivatives provided that they include representations to address some of the concerns expressed in the Commission's March 2010 press release. These representations are: (i) that the ETF's board periodically will review and approve the ETF's use of derivatives and how the ETF's investment adviser assesses and manages risk with respect to the ETF's use of derivatives; and (ii) that the ETF's disclosure of its use of derivatives in its offering documents and periodic reports is consistent with relevant Commission and staff guidance (together, the "No-Action Letter Representations"). The No-Action Letter stated that the Division would not recommend enforcement action to the Commission under sections 2(a)(32), 5(a)(1), 17(a), 22(d), and 22(e) of

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<sup>6</sup> The Adviser represents that the Adviser and the Sub-Adviser have managed and will continue to manage the Fund in the manner described in the Prior Release and the Rule 144A Representation (as defined below), and will not implement the changes described herein until the instant proposed rule change is operative.

<sup>7</sup> See No-Action Letter dated December 6, 2012 from Elizabeth G. Osterman, Associate Director, Office of Exemptive Applications, Division of Investment Management.

the 1940 Act, or rule 22c-1 under the 1940 Act if actively-managed ETFs operating in reliance on specified orders (which include the Trust's Exemptive Order<sup>8</sup>) invest in options contracts, futures contracts or swap agreements provided that they comply with the No-Action Letter Representations.<sup>9</sup>

The Prior Release included the following representation: "Consistent with the Exemptive Order, the Fund will not invest in options contracts, futures contracts, or swap agreements" ( the "Derivatives Representation"). In view of the No-Action Letter, the Exchange is proposing to delete the Derivatives Representation.

The Exchange now proposes that, to pursue its investment objective, the Fund be permitted to invest in exchange-traded and over-the-counter ("OTC") interest rate swaps, exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, exchange-traded and OTC non-U.S. currency swaps, exchange-listed currency options, forward currency contracts and non-deliverable forward currency contracts (collectively, "Derivative Instruments").<sup>10</sup> The use of Derivative Instruments

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<sup>8</sup> See note 5, supra.

<sup>9</sup> The Adviser acknowledges that, for the Fund to rely on the No-Action Letter, the Fund must comply with the No-Action Letter Representations, which include the following: (i) the Board of Trustees of the Trust (the "Trust Board") will periodically review and approve the Fund's use of derivatives and how the Adviser assesses and manages risk with respect to the Fund's use of derivatives and (ii) the Fund's disclosure of its use of derivatives in its offering documents and periodic reports will be consistent with relevant Commission and staff guidance.

<sup>10</sup> Non-deliverable forward currency contracts do not involve physical exchange of the two currencies of the subject contract, but instead a net cash settlement of the two currencies is made by one party to the other and is based upon the movement of the two currencies relative to each other. The net cash settlement occurs in a predetermined convertible currency. Non-deliverable forward currency contracts differ from conventional forward currency contracts in that there is not a physical exchange of the subject currencies at settlement, and non-deliverable forward currency contracts can be used on currencies that

may allow the Fund to seek to enhance return, to hedge some of the risks of its investments in securities, to substitute a position in an underlying asset, to reduce transaction costs, to maintain full market exposure (which means to adjust the characteristics of its investments to more closely approximate those of the markets in which it invests), to manage cash flows, to preserve capital or to manage its foreign currency exposures.<sup>11</sup>

Under normal market conditions, no more than 20% of the value of the Fund's net assets will be invested in Derivative Instruments.<sup>12</sup> In addition, at least 90% of the Fund's net assets that are invested in exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options will be invested in such instruments whose principal market is a member of the Intermarket Surveillance Group ("ISG"), which includes all U.S. national securities exchanges, certain U.S. futures

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may be less liquid and/or have a smaller market of trade.

<sup>11</sup> In particular, the Sub-Adviser contemplates that the Fund will utilize Derivative Instruments for hedging purposes. For example, the Sub-Adviser may seek to use futures contracts or swap agreements to hedge the Fund's assets against higher rates by reducing its [sic] overall duration.

<sup>12</sup> The Fund will limit its direct investments in futures, options on futures and swaps to the extent necessary for the Adviser to claim the exclusion from regulation as a "commodity pool operator" with respect to the Fund under Rule 4.5 promulgated by the Commodity Futures Trading Commission ("CFTC"), as such rule may be amended from time to time. Under Rule 4.5 as currently in effect, the Fund will limit its trading activity in futures, options on futures and swaps (excluding activity for "bona fide hedging purposes," as defined by the CFTC) such that it will meet one of the following tests: (i) aggregate initial margin and premiums required to establish its futures, options on futures and swap positions will not exceed 5% of the liquidation value of the Fund's portfolio, after taking into account unrealized profits and losses on such positions; or (ii) aggregate net notional value of its futures, options on futures and swap positions will not exceed 100% of the liquidation value of the Fund's portfolio, after taking into account unrealized profits and losses on such positions.

exchanges and certain foreign exchanges, or are parties to a comprehensive surveillance sharing agreement with the Exchange.<sup>13</sup>

The Prior Release stated that the Fund's investments would be consistent with the Fund's investment objective and would not be used to enhance leverage. In view of the Exchange's proposal to permit the Fund to use Derivative Instruments, the Fund's investments in Derivative Instruments could potentially be used to enhance leverage. However, the Fund's investments in Derivative Instruments will be consistent with the Fund's investment objective and will not be used to seek to achieve a multiple or inverse multiple of an index.

Investments in Derivative Instruments will be made in accordance with the 1940 Act and consistent with the Fund's investment objective and policies. The Fund will comply with the regulatory requirements of the Commission to maintain assets as "cover," maintain segregated accounts, and/or make margin payments when it takes positions in Derivative Instruments involving obligations to third parties (i.e., instruments other than purchase options). If the applicable guidelines prescribed under the 1940 Act so require, the Fund will earmark or set aside cash, U.S. government securities, high grade liquid debt securities and/or other liquid assets permitted by the Commission in a segregated custodial account in the amount prescribed.<sup>14</sup>

The Fund will include appropriate risk disclosure in its offering documents, including leveraging risk. Leveraging risk is the risk that certain transactions of the Fund, including the

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<sup>13</sup> For a list of the current members of ISG, see [www.isgportal.org](http://www.isgportal.org). As stated in the Prior Release, the Exchange notes that not all components of the Disclosed Portfolio for the Fund may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

<sup>14</sup> With respect to guidance under the 1940 Act, see 15 U.S.C. 80a-18; Investment Company Act Release No. 10666 (April 18, 1979), 44 FR 25128 (April 27, 1979); Dreyfus Strategic Investing, Commission No-Action Letter (June 22, 1987); Merrill Lynch Asset Management, L.P., Commission No-Action Letter (July 2, 1996).

Fund's use of Derivative Instruments, may give rise to leverage, causing the Fund to be more volatile than if it had not been leveraged.<sup>15</sup>

Based on the above, the Exchange seeks this modification regarding the Fund's use of Derivative Instruments. The Adviser represents that there is no change to the Fund's investment objective. The Adviser and the Sub-Adviser believe that the ability to invest in Derivative Instruments will provide the Sub-Adviser with additional flexibility to meet the Fund's investment objective.

The Exchange further notes that the Prior Release stated that the Fund may hold up to an aggregate amount of 15% of its net assets in illiquid securities (calculated at the time of investment), including, among other enumerated assets, Rule 144A securities. To clarify this statement given that Rule 144A securities are not necessarily "illiquid," the Adviser now represents that the Fund's limitation on holding up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment) would include Rule 144A securities deemed illiquid by the Adviser or Sub-Adviser, in accordance with Commission guidance (the "Rule 144A Representation").<sup>16</sup>

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<sup>15</sup> To mitigate leveraging risk, the Fund will segregate or " earmark " liquid assets or otherwise cover the transactions that may give rise to such risk.

<sup>16</sup> A change regarding the restriction on the Fund's investments in Rule 144A securities was reflected in a supplement to the Registration Statement, dated March 31, 2014. The Commission has stated that long-standing Commission guidelines have required open-end funds to hold no more than 15% of their net assets in illiquid securities and other illiquid assets. See Investment Company Act Release No. 28193 (March 11, 2008), 73 FR 14618 (March 18, 2008), footnote 34. See also, Investment Company Act Release No. 5847 (October 21, 1969), 35 FR 19989 (December 31, 1970) (Statement Regarding "Restricted Securities"); Investment Company Act Release No. 18612 (March 12, 1992), 57 FR 9828 (March 20, 1992) (Revisions of Guidelines to Form N-1A). A fund's portfolio security is illiquid if it cannot be disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the fund. See Investment Company Act Release No. 14983 (March 12, 1986), 51 FR 9773 (March 21, 1986) (adopting amendments to Rule 2a-7 under the 1940 Act); Investment Company Act

The Fund will continue to comply with all initial and continued listing requirements under NYSE Arca Equities Rule 8.600.

Except for the changes noted herein, all other facts presented and representations made in the Rule 19b-4 filing underlying the Prior Release remain unchanged.

The changes described herein will be effective upon (i) the effectiveness of an amendment to the Trust's Registration Statement disclosing the Fund's intended use of Derivative Instruments and (ii) when this proposed rule change has become operative. The Adviser represents that the Adviser, has managed and will continue to manage the Fund in the manner described in the Prior Release and the Rule 144A Representation, and will not implement the changes described herein until this proposed rule change is operative.

#### Impact on Arbitrage Mechanism

The Adviser believes there will be minimal, if any, impact to the arbitrage mechanism as a result of the use of derivatives. Market makers and participants should be able to value derivatives as long as the positions are disclosed with relevant information. The Adviser believes that the price at which Shares trade will continue to be disciplined by arbitrage opportunities created by the ability to purchase or redeem Creation Units (as defined below) at their net asset value ("NAV"), which should ensure that Shares will not trade at a material discount or premium in relation to their NAV.

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Release No. 17452 (April 23, 1990), 55 FR 17933 (April 30, 1990) (adopting Rule 144A under the Securities Act).

The Commission previously has approved listing and trading on the Exchange of issues of Managed Fund Shares that may invest up to an aggregate amount of 15% of a fund's net assets in Rule 144A securities deemed illiquid by a fund's adviser, in accordance with Commission guidance. See, e.g., Securities Exchange Act Release No. 71067 (December 12, 2013), 78 FR 76669 (December 18, 2013) (order approving listing and trading of shares of the SPDR MFS Systematic Core Equity ETF, SPDR MFS Systematic Growth Equity ETF, and SPDR MFS Systematic Value Equity ETF under NYSE Arca Equities Rule 8.600).



The Adviser does not believe there will be any significant impacts to the settlement or operational aspects of the Fund's arbitrage mechanism due to the use of derivatives. Certain derivatives may not be eligible for in-kind transfer, and such derivatives will be substituted with a "cash in lieu" amount (as described below) when the Fund processes purchases or redemptions of Creation Units (as defined below) in-kind.

#### Creation and Redemption of Shares

The Fund will issue and redeem Shares on a continuous basis, at NAV, only in large specified blocks each consisting of 50,000 Shares (each such block of Shares, a "Creation Unit"). The Fund will issue and redeem Creation Units in exchange for an in-kind portfolio of instruments and/or cash in lieu of such instruments (the "Creation Basket"). In addition, if there is a difference between the NAV attributable to a Creation Unit and the market value of the Creation Basket exchanged for the Creation Unit, the party conveying instruments with the lower value will pay to the other an amount in cash equal to the difference (referred to as the "Cash Component"). Cash will be conveyed in lieu of any Derivative Instruments that cannot be transferred in-kind.

The Fund's custodian, through the National Securities Clearing Corporation, will make available on each business day, prior to the opening of business of the New York Stock Exchange, the list of the names and quantities of the instruments comprising the Creation Basket, as well as the estimated Cash Component (if any), for that day. The published Creation Basket will apply until a new Creation Basket is announced on the following business day.

#### Valuation for Purposes of Calculating Net Asset Value

As indicated in the Prior Release, the Fund's NAV is determined as of the close of trading (normally 4:00 p.m., Eastern Time) on each day the New York Stock Exchange is open

for business and is calculated by taking the market value of the Fund's total assets, including interest or dividends accrued but not yet collected, less all liabilities, and dividing such amount by the total amount of Shares outstanding.

For purposes of calculating NAV, the Fund's investments are valued daily at market value or, in the absence of market value with respect to any such investment, at fair value, in each case in accordance with valuation procedures (which may be revised from time to time) adopted by the Trust Board (the "Valuation Procedures") and in accordance with the 1940 Act. All valuations are subject to review by the Trust Board or its delegate. A market valuation generally means a valuation (i) obtained from an exchange, an independent pricing service ("Pricing Service"), or a major market maker (or dealer) or (ii) based on a price quotation or other equivalent indication of value supplied by an exchange, a Pricing Service, or a major market maker (or dealer). The information summarized below is based on the Valuation Procedures as currently in effect; however, as noted above, the Valuation Procedures are amended from time to time and, therefore, such information is subject to change.

Exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options will typically be valued at the closing price in the market where such instruments are principally traded. OTC and exchange-traded swaps will typically be valued using a Pricing Service. Forward currency contracts and non-deliverable forward currency contracts will typically be valued at the current day's interpolated foreign exchange rate, as calculated using the current day's spot rate, and the thirty, sixty, ninety, and one-hundred-eighty day forward rates provided by a Pricing Service or by certain independent dealers in such contracts.

Certain Derivative Instruments may not be able to be priced by pre-established pricing methods. Such Derivative Instruments may be valued by the Trust Board or its delegate at fair value. The use of fair value pricing by the Fund is governed by the Valuation Procedures and conducted in accordance with the provisions of the 1940 Act. As a general principle, the current “fair value” of an asset would appear to be the amount which the owner might reasonably expect to receive for the asset upon its current sale. The use of fair value prices by the Fund generally results in prices used by the Fund that may differ from current market valuations or official closing prices on the applicable exchange. A variety of factors may be considered in determining the fair value of Derivative Instruments.

Because foreign exchanges may be open on different days than the days during which an investor may purchase or sell Shares, the value of the Fund’s Derivative Instruments that are traded on foreign exchanges may change on days when investors are not able to purchase or sell Shares. Derivative Instruments that are denominated in foreign currencies will be translated into U.S. dollars at the exchange rate of such currencies against the U.S. dollar as provided by a Pricing Service. All Derivative Instruments that are denominated in foreign currencies will be converted into U.S. dollars at the exchange rates in effect at the time of valuation.

#### Availability of Information

As described in the Prior Release, on each business day, before commencement of trading in Shares in the Core Trading Session on the Exchange, the Fund discloses on its website the Disclosed Portfolio as defined in NYSE Arca Equities Rule 8.600(c)(2) that will form the basis for the Fund’s calculation of NAV at the end of the business day. See “Disclosed Portfolio” below.

Pricing information for Derivative Instruments will be available from major broker-dealer firms, subscription services, and/or Pricing Services and, in addition, for exchange-traded Derivative Instruments, from the exchanges on which they are traded.

#### Disclosed Portfolio

The Fund's disclosure of derivative positions in the Disclosed Portfolio will include information that market participants can use to value these positions intraday. On a daily basis, the Fund will disclose on the Fund's website the following information regarding each portfolio holding, as applicable to the type of holding: ticker symbol, CUSIP number or other identifier, if any; a description of the holding (including the type of holding, such as the type of swap); the identity of the security or other asset or instrument underlying the holding, if any; for options, the option strike price; quantity held (as measured by, for example, par value, notional value or number of shares, contracts or units); maturity date, if any; coupon rate, if any; effective date, if any; market value of the holding; and the percentage weighting of the holding in the Fund's portfolio.

#### Surveillance

The Exchange represents that trading in the Shares will be subject to the existing trading surveillances, administered by the Financial Industry Regulatory Authority ("FINRA") on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws.<sup>17</sup> The Exchange represents that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and federal securities laws applicable to trading on the Exchange.

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<sup>17</sup> FINRA surveils trading on the Exchange pursuant to a regulatory services agreement. The Exchange is responsible for FINRA's performance under this regulatory services agreement.

The surveillances referred to above generally focus on detecting securities trading outside their normal patterns, which could be indicative of manipulative or other violative activity. When such situations are detected, surveillance analysis follows and investigations are opened, where appropriate, to review the behavior of all relevant parties for all relevant trading violations.

FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares, exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options with other markets and other entities that are members of the ISG, and FINRA, on behalf of the Exchange, may obtain trading information regarding trading in the Shares, exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options from such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares, exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.<sup>18</sup>

At least 90% of the Fund's net assets that are invested in exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed

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<sup>18</sup> For a list of the current members of ISG, see [www.isgportal.org](http://www.isgportal.org). The Exchange notes that not all components of the Disclosed Portfolio for the Fund may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options will be invested in such instruments whose principal market is a member of the ISG.

In addition, the Exchange also has a general policy prohibiting the distribution of material, non-public information by its employees.

## 2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)<sup>19</sup> that an exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

The Exchange believes that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that the Shares will continue to be listed and traded on the Exchange pursuant to the initial and continued listing criteria in NYSE Arca Equities Rule 8.600. The Fund will continue to comply with all initial and continued listing requirements under NYSE Arca Equities Rule 8.600.

Under the proposed rule change, the Fund seeks to invest in Derivative Instruments, consistent with the No-Action Letter. Under normal market conditions, no more than 20% of the value of the Fund's net assets will be invested in Derivative Instruments. The Fund's investments in Derivative Instruments will be consistent with the Fund's investment objective and will not be used to seek to achieve a multiple or inverse multiple of an index. Investments in Derivative Instruments will be made in accordance with the 1940 Act and consistent with the

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<sup>19</sup> 15 U.S.C. 78f(b)(5).

Fund's investment objective and policies. The Fund will comply with the regulatory requirements of the Commission to maintain assets as "cover," maintain segregated accounts, and/or make margin payments when it takes positions in Derivative Instruments involving obligations to third parties (i.e., instruments other than purchase options). If the applicable guidelines prescribed under the 1940 Act so require, the Fund will earmark or set aside cash, U.S. government securities, high grade liquid debt securities and/or other liquid assets permitted by the Commission in a segregated custodial account in the amount prescribed. Moreover, the Fund will include appropriate risk disclosure in its offering documents, including leveraging risk.

The proposed rule change is designed to promote just and equitable principles of trade and to protect investors and the public interest in that the Adviser represents that there is no change to the Fund's investment objective. With respect to the proposal to permit the Fund to invest in Derivative Instruments, the Adviser represents that use of Derivative Instruments may allow the Fund to seek to enhance return, to hedge some of the risks of its investments in securities, to substitute a position in an underlying asset, to reduce transaction costs, to maintain full market exposure, to manage cash flows, to preserve capital or to manage its foreign currency exposures. In addition, such proposed change will provide the Sub-Adviser with additional flexibility in meeting the Fund's investment objective. The Adviser has represented that it believes there will be minimal, if any, impact to the arbitrage mechanism as a result of the use of derivatives. In addition, the Commission has previously approved the use of derivatives similar to those proposed herein by issues of Managed Fund Shares traded on the Exchange.<sup>20</sup>

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<sup>20</sup> See, e.g., Securities Exchange Act Release Nos. 73081 (September 11, 2014), 79 FR 55859 (September 17, 2014) (SR-NYSEArca-2014-20) (order approving listing and trading on the Exchange of shares of the Reality Shares DIVS ETF under NYSE Arca Equities Rule 8.600); 72882 (August 20, 2014), 79 FR 50964 (August 26, 2014) (SR-NYSEArca-2014-58) (order approving listing and trading on the Exchange of shares of

Consistent with the Prior Release, NAV will continue to be calculated daily and the NAV and Disclosed Portfolio (as defined in NYSE Arca Equities Rule 8.600(c)(2)) will be made available to all market participants at the same time.

With respect to the proposal that at least 90% of the Fund's net assets that are invested in exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options will be invested in such instruments whose principal market is a member of the ISG, the Exchange notes that the Commission has previously approved such limitations for other funds listed on the Exchange under NYSE Arca Equities Rule 8.600.<sup>21</sup> In addition, such a representation assures that most applicable exchange-traded assets of the Fund will be assets whose principal market is an ISG member or a market with which the Exchange has a comprehensive surveillance sharing agreement.

With respect to the Adviser now representing that the Fund's limitation on holding up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment) would include Rule 144A securities deemed illiquid by the Adviser or Sub-Adviser, in accordance with Commission guidance, the Exchange notes that the Commission previously

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the PIMCO Short-Term Exchange-Traded Fund and the PIMCO Municipal Bond Exchange-Traded Fund under NYSE Arca Equities Rule 8.600).

<sup>21</sup> See, e.g., Securities Exchange Act Release Nos. 7882 (August 20, 2014) (SR-NYSEArca-2014-58) (order approving listing and trading on the Exchange of shares of the PIMCO Short-Term Exchange-Traded Fund and the PIMCO Municipal Bond Exchange-Traded Fund under NYSE Arca Equities Rule 8.600); 72641 (July 18, 2014), 79 FR 43108 (July 24, 2014) (SR-NYSEArca-2014-64) (order approving listing and trading on the Exchange of the ARK Innovation ETF, ARK Genomic Revolution ETF, ARK Industrial Innovation ETF, and ARK Web x.0 ETF under NYSE Arca Equities Rule 8.600).



has approved listing and trading on the Exchange of issues of Managed Fund Shares that may invest up to an aggregate amount of 15% of a fund's net assets in Rule 144A securities deemed illiquid by the Adviser or Sub-Adviser, in accordance with Commission guidance.<sup>22</sup>

In accordance with the Prior Release, the Fund will monitor its portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained, and will consider taking appropriate steps in order to maintain adequate liquidity if, through a change in values, net assets, or other circumstances, more than 15% of the Fund's net assets are held in illiquid assets.

The proposed rule change is designed to perfect the mechanism of a free and open market and, in general, to protect investors and the public interest in that it will facilitate the listing and trading of an actively-managed exchange-traded product that will enhance competition among market participants, to the benefit of investors and the marketplace. As noted, the additional flexibility to be afforded to the Sub-Adviser by permitting the Fund to invest in Derivative Instruments under the proposed rule change is intended to enhance the Sub-Adviser's ability to meet the Fund's investment objective. FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares, exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options with other markets and other entities that are members of the ISG, and FINRA, on behalf of the Exchange, may obtain trading information regarding trading in the Shares, exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures

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<sup>22</sup> See note 16, supra.

contracts, and exchange-listed currency options from such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares, exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement. At least 90% of the Fund's net assets that are invested in exchange-listed options on U.S. Treasury futures contracts, exchange-listed U.S. Treasury futures contracts, exchange-listed options on Eurodollar futures contracts, exchange-listed Eurodollar futures contracts, and exchange-listed currency options will be invested in such instruments whose principal market is a member of the ISG. In addition, as indicated in the Prior Release, investors will have ready access to information regarding the Fund's holdings, the PIV (as defined in the Prior Release), the Disclosed Portfolio (as defined in the Prior Release and as further described herein), and quotation and last sale information for the Shares.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes the proposed rule change will permit the Sub-Adviser additional flexibility in achieving the Fund's investment objective, thereby offering investors additional investment options.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>23</sup> and Rule 19b-4(f)(6)(iii) thereunder.<sup>24</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

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<sup>23</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>24</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSEArca-2014-127 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEArca-2014-127. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that

you wish to make available publicly. All submissions should refer to File Number SR-NYSEArca-2014-127 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>25</sup>

Kevin M. O'Neill,  
Deputy Secretary.

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<sup>25</sup> 17 CFR 200.30-3(a)(12).